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The Role of Value Added Tax on Economic Growth of Ethiopia

DM Jalata

Abstract

The achievement of economic growth is crucial for countries sustainable development. Recently, Value Added Tax (VAT) becomes a major worldwide tax instrument which enhances economic growth. Being a tax levied on the final consumption of goods and services, VAT is collected at each stage of production and distributions when value is added up on them. In Ethiopia, the adoption of VAT to replace the out dated general sales tax as of January 2003 becomes the central landmark tax reform. Accordingly, it has introduced a uniform standard rate of 15% VAT system on most of goods and services. Thus, this paper analyses the role of VAT on economic growth of Ethiopia from 2003 to 2012 based on theoretical and empirical evidences. To meet this objective, time series macro-economic data on GDP, VAT, total tax revenue excluding VAT, non-tax revenue and foreign revenue were used. This data is collected from Ministry of Finance and Economic Development, Ethiopian Economic Associations and Ethiopian Revenue and Customs Authority. Descriptive statistics and multiple regressions were employed to analyze the data. The finding of the study reveals that as compared to sales tax, VAT boosts the general economic growth of Ethiopia but the issue of regressively resembling to sales tax still continues. During the periods under review, the growth rate of VAT was 66.27% on average. For the periods of sales tax, the average growth rates of GDP were only 2.53%. However after executions of VAT, such growth rate reached about 21.9% on average. The analysis also showed as the average ratio of VAT to GDP becomes 2.95%. The finding also reveals that, VAT, total tax revenue and non-tax revenue except foreign revenue were significant at 5% level of significance but all of them positively contributed for economic growth during the periods under review. However, to be effective, it requires strong administrations and cooperation's of the tax payers with taxing authority and the government in general.

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